Department of Telecommunications and Energy
Record Requests

THE BERKSHIRE GAS COMPANY
D.T.E. 02-19

Witness: Karen L. Zink
Date: July 23, 2002

Question:

SRR DTE-1 For each member of the alliance please indicate whether margins, resulting from the Asset Optimization Agreement, will be shared between the companies' customers and the stockholders. If yes, please indicate the margin sharing percentages.

Supplemental
Response: The Hearing Officer requested that the Company provide a supplemental response to this record request to address the intentions of the Company, the Connecticut Natural Gas Corporation ("CNG") and The Southern Connecticut Gas Company ("SCG") with respect to margins generated from the management of resources pursuant to the alliance with BP Energy. The Hearing Officer also requested that the Company provide an analysis of the basis for such sharing in Massachusetts and Connecticut.

First, with respect to the Company, Berkshire expects to continue to treat margins generated pursuant to the application of its various capacity management tools, including interruptible transportation ("IT"), interruptible sales ("IS"), capacity release ("CR") and off-system sales, consistent with the precedent established in the Department's decision in D.P.U. 93-141-A. The Company has actively managed its supply, transmission and distribution resources when available in excess of the demands of core customers. The Company recognized that the ability to take advantage of market opportunities might enable the Company to generate margins that could reduce the cost of service for firm customers. See D.P.U. 93-141-A, pp. 59-60.

Berkshire has pursued these opportunities pursuant to a variety of transactional structures. For example, Berkshire has pursued IS and IT transactions directly with customers in its service area. The Company also retained Pendulum Resources to provide assistance with capacity release matters on a transactional basis. Tr. 298-299. Berkshire also worked with outside asset managers where these third-parties were compensated in return for the right to employ Berkshire's resources when not required for service to core customers. See Berkshire Gas Company, D.T.E., 99-81. The alliance with BP Energy Company has involved the pursuit of transactional opportunities more similar to the earlier advisory relationship with Pendulum Resources. In the alliance structure, the Company makes regular elections with respect to optimization transactions and BP Energy is compensated for its advisory service through a savings sharing mechanism. Berkshire therefore submits that margins generated pursuant to the alliance with BP Energy Company are appropriately treated pursuant to the "sharing" provisions of D.P.U. 93-141-A.

Several factors support this conclusion. First, as mentioned, it is important to consider the nature of the underlying transactions pursued within the alliance. The Company, with its alliance partners, pursued CR transactions and a variety of off-system sales. Indeed, optimization or management techniques involving "least cost pathing" only are able to be pursued in conjunction with an off-system sale. Thus, it is appropriate and entirely consistent with precedent to assign optimization or capacity management margins to the various "categories" established in D.P.U. 93-141-A. Berkshire notes that it will finalize the calculation of any margins based upon the results of the follow-up work described in the recent audit report. Second, the application of the established margin sharing procedures to alliance transactions is consistent with the principles articulated by the Department with respect to incentive regulation. The Department noted that margin sharing structures provide LDCs "with an incentive to consider seriously more aggressive capacity releases …." D.P.U. 93-141-A, p. 61. Absent the application of established margin sharing principles to the alliance, there would be no incentive for Berkshire to have incurred the more substantial costs associated with its aggressive and creative efforts to enhance its resource portfolio in terms of securing a least cost gas supply through the alliance. Thus, besides the fact that the alliance involves transactions that fit squarely within the established optimization categories, the application of these established margin sharing standards to alliance savings is fully consistent with the more general principles articulated in D.P.U. 93-141-A.

In terms of Connecticut, pursuant to Settlement Agreement among CNG and SCG, the Connecticut Office of Consumer Counsel and the Connecticut Department of Public Utility Control – Prosecutorial Division dated October 23, 2001, certain revisions to CNG's and SCG's approved rate plans were negotiated. The Settlement Agreement was subsequently approved by the Department of Public Utility Control in an order dated _____. The Settlement Agreement modified certain Earnings Sharing Mechanisms ("ESMs") pursuant to which CNG and SCG were afforded the opportunity to recover merger-enabled gas savings. The Settlement Agreement establishes the following specific terms to the ESMs:

> Effective October 1, 2001 and though September 30, 2002, SCG and CNG shall be entitled to retain 75% of the first 100 Basis Points of earnings over the authorized, allowed and approved Return on Equity (ROE) approved by the Department, for SCG in Docket No. 99-04-18

(10.71%, SCG ROE) Phase II and, CNG in Docket No. 99-09-03 Phase I (10.80%, CNG ROE) (collectively "the ROEs") and customers shall be entitled to receive 25% of the first 100 Basis Points of earnings over the ROEs. SCG and its customers shall share any earnings in excess of 11.71% on a 50/50 basis and CNG and its customers shall share any earnings in excess of 11.80% on an 50/50 basis.

Effective October 1, 2002 and through September 30, 2004, SCG and CNG shall be entitled to retain 75% of the first 50 Basis Points of earnings over the authorized, allowed and approved ROE approved by the Department, for SCG in Docket No. 99-04-18 (10.71%, SCG ROE) Phase II and, for CNG in Docket No. 99-09-03 Phase I (10.80%, CNG ROE) (collectively "the ROEs") and customers shall be entitled to receive 25% of the first 50 Basis Points of earnings over the ROEs. SCG and its customers shall share any earnings in excess of 11.21% on a 50/50 basis and CNG and its customers shall share any earnings in excess of 11.3% on a 50/50 basis.

Effective October 1, 2004 and through September 30, 2005, SCG and CNG shall share any earnings in excess of the authorized, allowed and approved ROE approved by the Department, for SCG in Docket No. 99-04-18 (10.71%, SCG ROE) Phase II and, for CNG in Docket No. 99-09-03 Phase I (10.80%, CNG ROE) on a 50/50 basis with customers.

Berkshire understands that the approval of the Settlement Agreement establishes the margin sharing mechanism for CNG and SCG. Berkshire also understands that CNG and SCG expect to be able to demonstrate that alliance margins are "merger-enabled" opportunities that are appropriately addressed pursuant to the ESMs.